**Supersedes:** MA 503-1 (01/01/08)

**References:** 42 CFR 435.601; 20 CFR 416.1110(b), 416.1111(b), and 404.1065 through .1096; ARM 37.82.101

GENERAL RULE--Net earnings from self-employment (NESE) are countable income when determining eligibility. Net earnings from self-employment are calculated differently for programs other than ABD Medicaid.

**DEFINITION OF SELF-EMPLOYMENT**

Self-employment is the act of engaging in a trade or business. A trade or business is generally an activity carried on for a livelihood or in good faith to make a profit. So long as a profit motive exists, an individual does not have to make a profit to be in a trade or business. Individuals may be contractors, franchise holders, owner/operators, partners, etc. They must meet all of the following criteria to be considered self-employed:

1. They earn their income directly from their business or trade, not from wages or salary from an employer;
2. They are responsible for the payment of their entire Social Security and Federal withholding taxes;
3. They do not have an employee/employer relationship with another individual and the services performed cannot be controlled by an employer (such as setting the job schedule, etc.);
4. They *should* file self-employment tax forms (Schedule F, C, C-EZ, SE, Form 1065, etc.). However, not all individuals file tax forms and some may file incorrectly. AND,
5. They “materially participate” in the production of the income in that their direct activities, such as physical labor, production of a product (such as a computer program, research document or a building), decision-making, etc. cause the income to be produced. When an individual materially participates in a self-employment

business, the income generated is directly affected by the number of hours the individual works.

**NOTE:** When an applicant/recipient claims to be self-employed, but has not filed income tax, other indications of a self-employment business include a business license, evidence of regular, sustained and on-going business activities, regular financial transactions in the business name, periodic advertising, accounts (bank accounts, charge accounts) in the business name, and registration of a business with the Secretary of State.

**►SELF-EMPLOYMENT STRUCTURES**

There may be many types of business structures referred to as self-employment by the filing/assistance unit. Some are considered self-employment for purposes of Medicaid eligibility, while others are not. Some of the more common structures are:

1. Sole Proprietorship: A self-employment business that is not incorporated and has one or two owners. The business income and liabilities are responsibilities of the one or two owners. (Limited liability companies—LLCs—are not sole proprietorships.)

► 2. Partnership: A business that is set up with two or more partners. In addition to personal income tax forms, partnerships are also required to file 1065 and K-1 forms. The business income and liabilities are the responsibility of all the partners, with the partnership defining shares of ownership and responsibility. Partnership income is determined in the same way as other self-employment. (Limited liability companies and limited partnerships do not meet this definition.)

► 3. Independent Contractor: An individual who pays his or her own employment taxes and does not have an employee/employer relationship is considered self-employed, unless incorporated or a LLC. Independent contractors should be registered with the State through the Dept. of Labor and Industry.

► 4. Sharecropper: If the sharecropper pays the costs of doing business and receives a portion of the net income in exchange for his/her labor, s/he is considered self-employed unless incorporated or a LLC. However, if the sharecropper is not responsible for paying the costs of doing business, s/he is not considered self-employed.

**►CORPORATIONS**

Individuals may incorporate their self-employment enterprises for various reasons. Because the businesses were originally self-employment, and the individuals may be the sole owners of the corporate stock, people with these arrangements often view the businesses as self-employment. Incorporated businesses are not, however, self-employment enterprises, and therefore, property owned by corporations and the corporate stock cannot be excluded as necessary for self-employment or necessary for self-support. Additionally, property owned by corporations cannot be excluded by virtue of the rule that no exclusion applies to property a filing or assistance unit does not own, nor based on use of such property. Income earned from a corporation is not considered self-employment income. Income received by an individual who works for the corporation is considered countable wages.

**NOTE:** Although wages paid to corporate officers are considered wages, fees paid to corporate directors are considered self-employment earnings to the corporate directors.

Any corporate income reported on Schedule E, Line 32 as income received from a corporation is only counted if it is actually distributed.

Any loss reported on Schedule E, Line 32, as loss received from a corporation is not used in any budget calculation.

**►LIMITED LIABILITY COMPANIES (LLC)**

Limited liability companies (LLCs) and limited partnerships are treated like corporations for eligibility purposes, regardless of what tax documents may be filed with the IRS (single-member LLCs are usually treated as sole proprietorships for tax purposes). Income other than “guaranteed salaries” received from a limited liability company or partnership is unearned income. Guaranteed salaries are treated as regular wages. No income from a LLC or limited partnership is NESE. Therefore, property owned by a LLC or a limited partnership cannot be excluded as necessary for self-employment or necessary for self-support. Additionally, property a filing or assistance unit does not own but that is owned by a LLC or a limited partnership cannot be excluded by virtue of the rule that no exclusion applies to property a filing or assistance unit does not own, nor to use of such property.

**ACTIVITIES THAT ARE NOT SELF-EMPLOYMENT**

The following income is not considered self-employment. They are unearned income sources and coded on the UNIN screen:

1. Rental income and rental partnership income (and other types of ownership-related income) where the individual is not materially participating in the business at least **10 hours per week** throughout the year or is not reporting the income as self-employment on Schedule C or F of their federal tax return (instead, passive rental income is often filed on Schedule E);

2. Contract for deed income (See MA 501-1);

3. Boarder income, in some instances (see “Boarders” in this section); and

4. Income received by a non-participating investment partner in a business (also known as a “silent partner”).

The types of income above are also known as passive income.

**RESOURCES**

Property which is essential to self-employment may be excluded as resources. See the following titles in this manual for **possible** exclusion of some items as resources:

- Property Essential for Self-employment (MA 402-1)
- Income Producing Property (MA 402-1)
- Business Checking Accounts (MA 402-1)
- Loans (MA 402-1)
- Vehicles (MA 403-1)

► No exclusions listed in this section will be applied to property a filing or assistance unit does not own, nor to use of such property except by owners who are members of the filing or assistance unit. This includes *but is not limited to* property which a filing or assistance unit does not own but is owned by or held in:

1. a trust of any kind (whether or not any member of the filing/assistance unit is a trust beneficiary or a trustor),

2. a corporation of any kind (whether or not any member of the filing/assistance unit is a corporate shareholder),

3. a partnership of any kind (whether or not any member of the filing/assistance unit is a partner),

4. a limited liability company of any kind (whether or not any member of the filing/assistance unit is a member of the company), or

5. any other legal entity, instrument, device or arrangement of any kind by which a filing or assistance unit does not own the property.

Owners of LLCs, corporations, and other similar business arrangements do not own the property of the company or business, but rather own stock or a share of the business entity.

**INCOME EXCLUSIONS**

Exclude the following:

1. federal gasoline tax credit;
2. state gas tax;
3. disaster payments (see MA 501-1); and
4. capital gains.

**PATRONAGE DIVIDENDS**

Patronage dividends paid to a self-employment enterprise are countable as part of gross self-employment income, even if paid in stock. Resources that have been prorated as income are excluded as resources during the period over which they are prorated as income.

**AGRICULTURAL STABILIZATION & CONSERVATION SERVICES (ASCS)**

Cash payments are counted as earned self-employment income. These include but are not limited to: Commodity Credit Corporation, acreage reduction and conservation payments and other one-time or installment payments made to farmers for crop or other losses unrelated to a Presidentially declared disaster. If the payment is due to a Presidentially declared disaster, it is excluded as both income and a resource due to the Disaster Relief Act.

**CANCELED DEBT**

Canceled debt is used in determination of net earnings from self-employment if included on tax forms. Do not routinely question information on tax forms unless an amount seems unreasonable.

**CAPITAL GAINS & CAPITAL LOSSES**

Capital gains are increases in the value of property between the time purchased and the time sold. Capital losses are decreases in the value of property between the time purchased and the time sold. For self-employment businesses, depreciation plays a role in determining whether capital gains/losses occur. Capital gains/losses are normally determined at the time property is sold.

Capital gains and losses from the sale of self-employment property are excluded.

**IN-KIND INCOME & BARTERING**

If the self-employment business (including a farm) provides all or part of a household's shelter and/or food, this may be earned or unearned in-kind support and maintenance, valued using the Presumed Maximum Value Rule or One-third Value Provision, in MA 500. This in-kind income may be earned or unearned, depending on if it is being provided to the individual who is self-employed (in which case it is earned) or to other household member(s) who do not work for the business (in which case it is unearned). If food and/or shelter are provided to an entire household, the value must be assigned as in-kind income among the household members.

Bartering is considered in-kind services exchanged between two self-employed businesses, such as an exchange of storage space for furnace repair. The goods or services received in a bartering situation must be evaluated to determine whether they meet the requirements as countable income.

**►ALLOWABLE EXPENSES**

Allowable expenses are excluded from self-employment income. Most costs of doing business are allowable expenses and may be accepted as listed on the income tax forms with few exceptions (such as if questionable). Expenses must be current, not due from a previous fiscal period, and are only allowed when paid.

**NOTE:** When anticipating self-employment income for a new business or significant change, expenses expected to be due and paid in the prospective period may be anticipated to offset the anticipated income.

Some self-employed individuals do not claim all expenses on their Schedule C in order to qualify for Earned Income Tax

Credit. The allowable expenses that are not shown on the Schedule C can be verified by the applicant/recipient and should be used in determining accurate self-employment earnings.

The following are examples of allowable expenses: labor paid to non-household members (individuals not included in the filing unit), materials, seeds, supplies, plants, fertilizer, interest payments on business loans, business portion of home property or expense, repairs, etc.

**NOTE:** Supplies include small tools, paper, pencils, scissors, oil, gas, envelopes, shampoo, hairbrushes, crayons/coloring books, etc. Supplies are generally described as objects that will normally be used up or consumed in service.

Transportation costs for doing business may be allowed. However, the cost of commuting to the business from home is not allowed, including the cost of commuting to the job site if the business does not have a set "place of business". Mileage expense is allowed at the Federal expense rate if mileage is tracked; if mileage records do not exist, then expenses for fuel and vehicle repairs and maintenance may be allowed; however, the Federal expense rate and "vehicle repairs, maintenance and fuel" may NOT be allowed for the same vehicle for the same time period.

Depreciation is an allowable expense.

A 7.65% deduction is applied to net profit in determining net self-employment income. This deduction recognizes, as a business expense, the "employer-paid" portion of the Social Security tax paid. This expense must be manually calculated and entered on the SEEW screen. See example at the end of this section. This is only allowed if the tax is actually paid, and therefore would not be allowed if the net self-employment income were $400 or less per year before the 7.65% deduction, or if the individual indicated to the eligibility case manager that there was no intention to pay this (or if history indicates that it has not been paid in the past). This amount is reflected on Schedule SE (line 6 on short form, line 13 on long form).

**DEPENDENT CARE BUSINESS EXPENSES (Cost of meals)**

Household's deriving income from dependent care, such as providing day care for children, elderly, or disabled individuals, may elect one of the following methods to determine the cost of meals provided to the individuals:

1. Actual documented meals.
2. A standard per day amount based on estimated meal costs.
3. Current reimbursement amounts used in the Child and Adult Care Food Program.

**NON-ALLOWABLE EXPENSES**

Non-allowable expenses must be added back into the self-employment income if income tax forms are used, or not allowed as a deduction in the monthly calculation of self-employment income.

The following are examples of non-allowable expenses:

1. Purchase costs of capital assets and durable goods, even if the capital asset or durable good is not set up on a depreciation schedule. Capital assets and durable goods are objects used in business that are expected to last a long time, such as farm machinery, equipment, swing sets, buildings, computers, cribs, VCRs, furniture, high chairs, tricycles, vehicles, hair dryers, etc. <u>All items</u> purchased for a business prior to the opening of the business are capital expenses.

2. Repayment of loan principal (since the loan was never considered income); however, the <u>interest</u> payment on business loans may be deducted.

3. Federal, state, and local income taxes. And

4. Transportation to and from work.

**FARM SELF-EMPLOYMENT CONNECTED TO HOME**

When a household's home is on property connected to the property used for farming or another self-employment business enterprise, the eligibility case manager must determine if the shelter costs (e.g. rent or mortgage)and the self-employment costs can be separately identified.

If necessary, the eligibility case manager is required to determine a breakdown of farm (or business) expenses from personal home shelter expenses by using:

1. Household's calculation of breakdown;

   **NOTE:** The 'Farm Self-Employment Questionnaire' (HCS-516) can be used as a tool to determine if the household included any personal shelter expenses with their farm deductions
2. Income tax form breakdown; or,

   **NOTE:** If the household presents self-employment tax records (Schedule C or F), do not question the shelter deductions (utilities, insurance, interest, etc.) included on those documents.

3. Verifications submitted by the household (i.e., tax verifications; loan papers indicating cost of land, buildings, equipment, etc. versus cost for house/ garage/personal equipment; insurance policy breakdowns of cost of premiums for farm/business and personal home costs; etc.).

If a self-employed individual cannot (or will not) provide proof of his separate business and personal shelter expenses, no questionable expenses will be allowed in calculating his self-employment income.

**IN-HOME BUSINESS EXPENSE**

When the self-employment enterprise is conducted in the home and the household wishes to claim a portion of the shelter expense as a business deduction, the eligibility case manager must separate business expenses from personal home expenses. The portion of the home that is used on an exclusive basis for a business is allowed as a business expense. However, the household is not required to use the business portion as a business deduction.

The following criteria must be met to use home shelter costs as a business expense:

1. A substantial amount of time must be spent doing business in the home (not occasionally).

***If the in-home business is NOT related to dependent care, the business must also meet one of the following two conditions.***

2. An allowance for space regularly used for inventory storage may be allowed if the space is identifiable and

only used for self-employment; ***or***,

3. The portion of the home must be used on an exclusive basis (the space allocated to the business must be used only for the business).

**NOTE:** The portion of the home cannot be used only for administrative work. (Example: if the majority of the income is made outside of the home and the home is not needed for storage purposes, no separation of expenses is allowed.)

With the agreement of the applicant/recipient, the eligibility case manager will determine the usage of home for business purposes by:

1. The household's calculation of use.

**NOTE:** The 'Self-Employment Questionnaire' (HCS-518) may be used as a tool for businesses other than farming or dependent care. The "Self-Employment Questionnaire for Dependent Care Providers" (DPHHS-HCS-517) may be used as a tool for dependent care providers.

2. Form 8829 percentage (only if the business and personal home costs are separated on this form); or

3. The ratio of business square footage to square footage of the entire home.

Do not question the separation of business and home expenses on the income tax forms unless there is a question about the accuracy of the information, such as in a case where the household's entire shelter expense is deducted as a business expense. If this occurs, the amounts may be recalculated as directed above, or the eligibility case manager may agree with the applicant/recipient to assign the value of the shelter as in-kind income to the household. (See in-kind income in this section as well as in MA 502-1, and "Presumed Maximum Value Rule" or "One-Third Value Provision" in MA 500.)

**BUDGETING**

Self-employment income is always annualized (see MA 601-1), regardless of whether the income is intended to support the household for the entire year or not, or when the business starts or ends during a year (unless the self-employed individual dies or changes taxable fiscal year ONLY).

Examples:

1. A self-employed logger may not work during the spring due to “spring break-up” (cannot log due to mud). His yearly income must be annualized even though he only works nine months per year. Self-employment will count as earned income even in the months that he is not working.

2. A vendor who works only in the summer and supplements his income from other sources during the rest of the year would have his self-employment income annualized.

Since self-employment income is annualized, the expenses must also be annualized. Expenses are counted when paid, not when billed.

Income tax forms should be used to determine income (when available). The most current tax forms must be used unless there is a substantial change in the nature of the business or the amount of income. Income must be annualized whether or not tax forms reflect current income and whether or not they are available. Other documentation must be used to determine annualized income.

Some examples of substantial changes in a business are:

1. Termination of, or starting a new self-employment enterprise, such as changing from a grain and cattle operation to a cattle operation or changing from a sewing machine repair and fabric shop to only a fabric shop;

2. Significant increase in or reduction of operation, such as adding or reducing a quarter section of crop land, or significantly increasing or decreasing a store’s size and inventory; and

3. Natural disasters such as hail or drought. Normal year-to-year fluctuation in market prices would not be considered to be substantial increases or decreases. However, abnormal changes may be considered. For

instance, if the price of wheat is normally $2 to $4 per bushel, a reasonably anticipated change to $6 or $1 would be considered a substantial change once the crop is sold and this new income information would then be used.

Example: A day care provider has submitted her last year's taxes that reflect $12,000 self-employment income earned from providing care for five children; however, in the next year she will only be licensed to provide care for three children. Her anticipated day care income must be annualized. She now expects to earn a net income of $9,000 in the next year, so her projected monthly countable self-employment income would be $750 ($9000 ÷ 12). This projected income would be used even though she might expect her actual monthly income to vary over the next year (i.e., some months her actual income would be $900 and some months it might be $600).

**NEW BUSINESS**

For a new business, the income must be averaged using the income and expenses from the months the business has been in operation until 12 months have been reached. If there is no reliable history of income or expenses to average, the eligibility case manager must negotiate a projection of the anticipated monthly income and expenses with the applicant.

Example: Jane starts a massage business in June. When she reports the new business in June, she and her eligibility case manager will discuss her anticipated income and expenses for July and August and anticipate an income amount for those months (or perhaps some other short representative time period). Jane will be reminded that any changes in her business income will require her to report a change. A system alert will be set for August to check in with Jane regarding her income to that point. At that time, her June through August income and expenses will be calculated and divided by 3 (unless the business started late in June, in which case June may be disregarded in the anticipation calculation).

Jane would periodically continue to provide updated information until the following July, at which point there would be a full 12-month period upon which to base the income anticipation.

**RENTAL INCOME**

Depending on how active an individual is in managing rental property, the income can be considered either self-employment (SEEI) or unearned income (UNIN). Regardless of this designation, the cost of doing business is deducted from the gross income to determine net countable income to be annualized for benefit calculation.

Refer to information under the 'Activities That are Not Self-Employment' caption in this section for explanation of how to determine whether rental income is self-employment on a case-by-case basis. If the income is determined to be unearned, the countable income calculation must be done manually (TEAMS will not do this; CHIMES, however will accept income and expense information and calculate net countable income), using gross income minus the allowable expenses (see 'Allowable Expenses' caption earlier in this section). In TEAMS, enter the countable amount on UNIN as 'RE'. (See also "Income Producing Property" in 402-1 for resource information.)

Document in case notes whether the income is being counted as unearned income or earned self-employment and how the expenses and income were derived.

**ROOMERS**

A roomer is an individual living with a household and paying for lodging but not meals. Use guidelines under the caption "Activities that are not Self-employment" earlier in this section to determine whether the contribution is considered earned or unearned income.

Payments received from roomers will normally be considered unearned contributions to the household.

Payments received from roomers will be offset by a pro rata share of the housing expenses based on the number of rooms rented compared to the number of rooms in the entire residence (excluding bathrooms and attics/basements unless they have been converted into living space).

**BOARDERS**

Treat commercial boarding houses (businesses established as commercial enterprises which offer meals and lodging for compensation with the intent to make a profit) according to the general provisions of self-employment, rather than according to information provided below.

Boarders are individuals to whom a household furnishes lodging and meals. Foster children are not considered boarders.

When a boarding situation is not related to a commercial boarding house, the income is determined according to the following provisions.

Income from boarders includes all direct payments to the household including contributions for meals and shelter. In determining the amount of countable income received from the boarder, exclude the household's costs of providing room and meals to the boarder (allowable expenses).

The household may choose one of the following methods to determine the business expenses:

1. The actual documented allowable expenses related to providing room and meals, including a pro rata share of food, utilities, etc., or

2. One-third the Standard Payment Amount (SPA) of SSI at the time. This is allowed, as it would be considered the value of the room and board furnished to the boarder if s/he were not paying for the food and shelter.

**LOSSES FROM SELF-EMPLOYMENT**

Verified self-employment losses (not corporation losses) are deducted from any other earnings of the individual or couple. Such losses are not deducted from any unearned income sources. If a loss is offsetting non-self-employment earnings for ABD Medicaid, TEAMS will NOT do this offset for you. The amount must be manually deducted from the countable earnings and the result coded 'OM' on EAIN. If other programs are involved, the countable earnings may be coded in full for the other programs using 'OF' and/or 'OA' (see other program manuals for individual program policies). Enter case notes.

Losses from corporations are not used to offset any other income.

**BANKRUPTCY**

If bankruptcy is filed, the projected monthly self-employment income continues to be used unless the household states the business will have substantial change (MA 503-1, “Change Reporting”) in income and expenses. This would be verified with a statement from the bankruptcy trustee regarding the debt reorganization plan concerning the anticipated gross income and expenses.

The income will continue to be projected to the end of the business’ fiscal year (unless the self-employed person has died), although the amount projected may change.

The self-employment income continues to count even if diverted to a bank, trustee or other source. No deduction is allowed for the trustee or conservator’s fees.

If the equipment/land is repossessed or the title is given to the lender, the property is the legal property of the lender and sale of the property is not considered income. However, if the title remains in the household’s name and the lender arranges the sale, the property belongs to the household and the amount is counted as a resource whether received as periodic payments or as a lump sum.

If the lender forgives or writes off a loan, the amount forgiven or written off is not considered income.

**CHANGE REPORTING**

A participant is required to report substantial changes in income or the business within 10 days of knowledge.

A substantial change could be:

1. Crop failure or flood.
2. Substantial market increase or decrease.
3. More or less land farmed/operation size.
4. Change in operation (from livestock to crops, dairy to sheep, or general contractor to concrete only).
5. More or fewer children in a dependent care business, loss or gain of a major contract, etc.

A change in the amount of net income is substantial if the change will result in a difference of $25/month or more to the prorated monthly net self-employment income for the entire period in which the income is countable.

Applicants/recipients are also required to report changes in the source of income, such as if they stopped actively farming and are renting out their land.

If the household anticipates a substantial change, the eligibility case manager may choose to shorten the redetermination period to allow closer monitoring of the effect of the reported change.

If there is no substantial change in operation or income and the source of income hasn't changed, but the household turns in the new income tax forms prior to redetermination, the eligibility case manager must recalculate the self-employment income based on the new tax forms. This is because all reported changes must be acted upon. Timely and/or adequate notice of adverse actions must be provided.

Example: Redetermination is due in August. However, the household submits tax return on February 10. The tax forms must be used to re-annualize self-employment income for March benefits. At the redetermination in August, the income will continue based on the current tax forms unless a change is reported prior to or at the redetermination. The eligibility case manager may want to consider setting future redetermination due dates for February or March of each year.

**REDETER-MINATIONS**

Eligibility will be continuous after the initial determination of eligibility and benefits. Except for scheduled redeterminations, benefits and eligibility will be redetermined based on change reports. See MA 1502-1 for specific redetermination requirements.

The redetermination period should be determined based on the period of time the self-employment income was intended to cover but not longer than 12 months from date of application or last redetermination. The eligibility case manager may choose to set redetermination dates (within the above criteria) to coincide with events such as the yearly sale of crops or the filing of income tax.

**EXAMPLE**

Lucia is a disabled self-employed adult. Lucia has been self-employed for two years as an independent contractor writing software programs. She works about 8 hours per week, but all income is directly related to her 'material participation' in this business (income is directly related to the number of hours she works…if she works less, the income goes down; if she works more, the income goes up; if she doesn't work at all, the income isn't produced at all). Lucia provides a copy of her last year's income tax return. She does not expect her income to differ significantly for the current year. Lucia's Schedule C indicates that her gross income for last year was $7500. Her expenses include depreciation, insurance, supplies, and meals totaling $1500. These are all allowable expenses.

**Special processing for ABD-MA:** *The eligibility case manager must manually calculate 7.65% of the annual NESE as calculated by the system [$6000 X 7.65% = $459], (may also be found on the Schedule SE from Lucia's income tax return) and would enter that figure as a new expense and re-calculate the countable NESE for ABD-Medicaid (now $461.75).*

**COMBINED CASE PROCESSING**

Cases including a combination of programs that do not use the same policies for determining the net self-employment income (in this example, Food Stamps and ABD-MA) are worked as if they were separate sources of income on the TEAMS SEEI screen. The income would be coded for each program on SEEW as follows: if the income is being determined for Food Stamps, the FS PRD is set at '012' (or other period of intended use as appropriate for the situation), and AF PRD, MA PRD, QM PRD, SL PRD and CC PRD would be set at '000'. Once the system returns to SEEI with an income showing in the PGM row for FS, the 'MORE INCOME' indicator at the bottom of SEEI would be set to 'Y', and a new SEEI screen would be completed to access a new SEEW screen, on which the MA PRD would be set at '012' (also the QM PRD and/or SL PRD should be set to '012'), and the FS PRD and AF PRD would be set to '000'.

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